

# **Blue Cross & Blue Shield of Rhode Island**

## **Cost Accounting System**

### **Overview**

January 17, 2001

## **Background**

Cost Accounting deals with the classification, recording, allocation, summarization, and reporting of administrative expenses.

In allocating administrative expenses to product lines of business, Blue Cross & Blue Shield of Rhode Island follows established policies and procedures provided in the Blue Cross and Blue Shield Association Cost Accounting Manual. In addition, the cost accounting principles and procedures of the Cost Accounting Standards Board and Federal Acquisition Regulations must be followed since Blue Cross & Blue Shield of Rhode Island administers various federal government contracts.

A brief description of the Cost Accounting Manual, Cost Accounting Standards Board, and Federal Acquisition Regulations follows.

## **Cost Accounting Manual**

The purpose of the Blue Cross and Blue Shield Cost Accounting Manual is to provide the Plans with a set of established policies and procedures for the classification, allocation, and presentation of Plan administrative costs. These principles and guidelines have been based upon generally accepted accounting principles, the National Associations' guidelines, and industry practices.

The objective of the use of the information contained in this manual is to provide a common foundation for cost assemblance in a manner that is compatible with the various Program requirements and is comparable with data generated among all Plans. Uniformity and consistency of data preparation and reporting must be practiced by all Plans to ensure that cost identification is meaningful and of value for internal and external performance appraisal, decision making and to meet external reporting obligations.

Each Plan has the responsibility to ensure that its cost accounting system adheres to the policies and procedures set forth in this manual in order to meet the following obligations:

- To provide uniformity in the allocation and reporting of cost by operations and lines of business.
- To provide reliable cost data for purposes of administrative expense reimbursement.
- To provide reliable cost data for management decision making purposes.
- To provide data for inter- and intra-Plan comparisons aimed at improving operational performance efficiency.
- To improve administrative cost information for budgetary purposes.

## **Cost Accounting Standards Board (CASB)**

The Cost Accounting Standards Board is an organization created by the United States Congress in 1970. Discontinued in 1981 and re-established in 1988, its purpose is to establish uniform

cost accounting standards for negotiated federal contracts and subcontracts exceeding \$500,000. The standards created by the CASB remain in place and must be adhered to by government contractors to ensure consistency and equitability in allocating allowable direct and indirect administrative expenses to government lines of business.

### **Federal Acquisition Regulations (FAR)**

The Federal Acquisition Regulations contain cost principles and procedures to be used by prospective government contractors in pricing of contracts, subcontracts, and modifications to contracts and subcontracts whenever cost analysis is performed for negotiating, billing and reimbursement of allowable costs.

### **General Description of the Cost Accounting System**

A determination is made of each type of operating expense incurred to ascertain what cost center incurred the expense and what corporation(s) and lines of business benefited from the activity that resulted in the incurrence of the expense. Once a determination is made as to who benefits from the activity that resulted in an expense, the expense is allocated using reliable statistics and prescribed methods of allocation contained in the Cost Accounting Manual and the requirements of the Cost Accounting Standards Board and Federal Acquisition Regulations where applicable.

A coding mechanism is used to charge each expense to a:

1. Natural Expense Account

- a. Salaries & Wages
- b. Payroll Taxes
- c. Health Insurance
- d. Office Equipment
- e. Office Supplies
- f. Telephone
- g. Rent
- h. Business Conferences
- i. Advertising
- j. Consulting Services
- k. Postage
- l. All other major types of expenses

2. Cost Center – an organizational unit used to accumulate cost of similar or identical tasks which can be assigned directly to a line of business or equitably allocated to two or more lines of business.

3. Corporation

- a. Blue Cross & Blue Shield
- b. Coordinated Health Partners, Inc.

4. Line(s) of Business – product lines of a corporation. Line(s) of business are charged with Direct Expenses and Indirect Expenses. An expense incurred for the benefit of one line of business only is considered a Direct Expense. An expense incurred which benefits more than one line of business is considered an Indirect Expense.

The following examples will identify how Direct and Indirect expenses are allocated utilizing the above mentioned Cost Accounting System.

Direct Expenses

1. A consultant is hired to do a Marketing Study for local Direct Pay line of business. At the completion of the study a bill is presented for payment in the amount of \$50,000. The allocation would be as listed below.

<u>Natural Expense</u> <u>Account</u>	<u>Cost</u> <u>Center</u>	<u>Corporation</u>	<u>Lines of Business</u>	<u>Amount</u>
Consulting Svcs.	Marketing	BCBSRI	Direct Payment	\$50,000

2. Outside printing expenses are incurred for Plan 65 brochures which explain benefits. The vendor was H. T. Woods and the cost was \$1,558.

<u>Natural Expense</u> <u>Account</u>	<u>Cost</u> <u>Center</u>	<u>Corporation</u>	<u>Lines of Business</u>	<u>Amount</u>
Outside Printing	Corp. Comm	BCBSRI	Plan 65	\$1,558

3. Allied Court Reporter sends us an invoice for stenographic services at a recent Plan 65 rate filing. These costs were \$1,690.

<u>Natural Expense</u> <u>Account</u>	<u>Cost</u> <u>Center</u>	<u>Corporation</u>	<u>Lines of Business</u>	<u>Amount</u>
Misc. Expenses	Corp. Ex.	BCBSRI	Plan 65	\$1,690

4. Partridge, Snow & Hahn, legal counsel, is retained to assist with rate filing matters for Direct Payment business. The costs were \$18,135.

<u>Natural Expense</u> <u>Account</u>	<u>Cost</u> <u>Center</u>	<u>Corporation</u>	<u>Lines of Business</u>	<u>Amount</u>
Legal Services	Legal	BCBSRI	Direct Payment	\$18,135

### Indirect Expenses

1. The Cash Disbursements Department is responsible for disbursing benefit checks to providers and subscribers for Blue Cross & Blue Shield of Rhode Island. A cost center "Disbursement Underwritten" is in place for all activities related to disbursing Group, Plan 65, and Direct Payment benefit checks within this department. Through payroll records and vendor invoices it is determined that this Cash Disbursements cost center incurred the following expenses for the month.

Salaries & Wages	\$10,000
Payroll Taxes	700
Health Insurance	500
Telephone	50
Rent	600
Office Supplies	<u>300</u>
Total	<u>\$12,150</u>

The method of allocation for this cost center is a Paid Claims Ratio. Paid Claims statistics for underwritten lines of business for the month as noted below will be used for allocation of the above expenses to Group, Plan 65 and Direct Payment lines of business.

<u>Final Line of Business</u>	<u>Paid</u> <u>Claims</u>	<u>Ratio</u>
Group Business	2,000	67
Plan 65	700	23
Direct Payment	<u>300</u>	<u>10</u>
Total	<u>3,000</u>	<u>100</u>

The expenses are recorded in the cost allocation system in a similar manner as the Direct expenses (see below).

<u>Natural Expense</u> <u>Account</u>	<u>Cost</u> <u>Center</u>	<u>Corporation</u>	<u>Lines of Business</u>	<u>Amount</u>
Salaries	Disb. Und.	BCBSRI	Underwritten	\$10,000
Payroll Taxes	Disb. Und.	BCBSRI	Underwritten	700
Health Ins.	Disb. Und.	BCBSRI	Underwritten	500
Telephone	Disb. Und.	BCBSRI	Underwritten	50
Rent	Disb. Und.	BCBSRI	Underwritten	600
Office Supplies	Disb. Und.	BCBSRI	Underwritten	<u>300</u>
Total				<u>\$12,150</u>

The allocation of the above expenses based on the Paid Claims Ratio would result in the following allocation to the final lines of business.

Blue Cross & Blue Shield  
Final Lines of Business

	<u>Group</u>	<u>Plan 65</u>	<u>Direct Payment</u>	<u>Total</u>
Salaries	\$6,700	\$2,300	\$1,000	\$10,000
Payroll Taxes	470	160	70	700
Health Ins.	335	115	50	500
Telephone	34	11	5	50
Rent	402	138	60	600
Office Supplies	<u>201</u>	<u>69</u>	<u>30</u>	<u>300</u>
Total	\$8,142	\$2,793	\$1,215	\$12,150

- The Human Resources Department's function is to provide Salary Administration, Benefits Administration, Employee Recruitment Services, Employee Training and Equal Employment Opportunity Programs for the organizations. The salaries for the month per the payroll records equate to \$100,000. A Total Corporate Employee Ratio by lines of business is the method of allocation used to allocate the Department's salaries expense and all other expenses incurred to each corporation's final lines of business. For illustration purposes only the salaries expense will be displayed.

<u>Natural Expense</u> <u>Account</u>	<u>Cost</u> <u>Center</u>	<u>Corporation</u>	<u>Lines of Business</u>	<u>Amount</u>
Salaries & Wages	Human Res.	All	All	\$100,000

Productive hours statistics for the month were used to develop the Total Corporate Employee Ratio as noted below.

<u>Final Line of Business</u>	<u>Employee Count</u>	<u>Total Corporate Employee Ratio</u>
Group	320	20
Major Medical	320	20
Plan 65	160	10
Medicare A	192	12
Medicare B	320	20
Blue Cross Dental	160	10
Direct Payment	64	4
Student	32	2
Coordinated Health Partners, Inc.	<u>32</u>	<u>2</u>
Total	1,600	100

Using the Total Corporate Employee Ratio, the salaries expense is allocated to final lines of business and the result is as follows:

Blue Cross & Blue Shield Corporation

<u>Final Lines of Business</u>	<u>Salaries</u>
Group	\$ 20,000
Blue Cross Dental	10,000
Major Medical	20,000
Plan 65	10,000
Medicare A	12,000
Medicare B	20,000
Direct Payment/Student	<u>6,000</u>
Total	<u>\$ 98,000</u>

Coordinated Health Partners, Inc.

<u>Final Lines of Business</u>	<u>Salaries</u>
Coordinated Health Partners, Inc.	<u>\$ 2,000</u>
Total	<u>\$ 2,000</u>

-Human Resources Department's Total Salaries	<u>\$100,000</u>
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### 2003 FTE Calculation

Monthly - Regular	
M01	155.60
M02	155.60
M03	155.60
M04	155.60
M05	233.39
M06	155.60
M07	155.60
M08	155.60
M09	155.60
M10	233.39
M11	155.60
M12	155.60

Yearly - Regular	
M01	155.60
M02	311.19
M03	466.79
M04	622.38
M05	855.78
M06	1,011.38
M07	1,166.97
M08	1,322.57
M09	1,478.16
M10	1,711.56
M11	1,867.15
M12	2,022.75

Monthly - Overtime	
M01	150.23
M02	150.23
M03	150.23
M04	150.23
M05	225.35
M06	150.23
M07	150.23
M08	150.23
M09	150.23
M10	225.35
M11	150.23
M12	150.23

Yearly - Overtime	
M01	150.23
M02	300.46
M03	450.69
M04	600.92
M05	826.27
M06	976.50
M07	1,126.73
M08	1,276.96
M09	1,427.19
M10	1,652.54
M11	1,802.77
M12	1,953.00

Monthly - Temp	
M01	170.50
M02	155.00
M03	162.75
M04	170.50
M05	162.75
M06	162.75
M07	170.50
M08	155.00
M09	162.75
M10	170.50
M11	139.50
M12	170.50

Yearly - Temp	
M01	170.50
M02	325.50
M03	488.25
M04	658.75
M05	821.50
M06	984.25
M07	1,154.75
M08	1,309.75
M09	1,472.50
M10	1,643.00
M11	1,782.50
M12	1,953.00



**Blue Cross & Blue Shield of Rhode Island**  
**Direct Pay - Comparison of CY07 Budget to CY06 Projected Actual by Natural Account**

	<u>CY2006 Projected</u>	<u>CY 2007 Budget</u>	<u>Increase (Decrease)</u>	<u>%</u>
Salaries And Wages	\$1,531,579	\$1,553,866	\$22,287	1.5
Temporary Empl Serv	12,410	11,951	(459)	(3.7)
Fringe Benefits	671,896	656,907	(14,989)	(2.2)
Outside Services	223,077	251,549	28,471	12.8
Legal	151,694	157,215	5,521	3.6
Rent	151,734	156,470	4,736	3.1
Equipment	68,322	54,133	(14,189)	(20.8)
Software	151,543	153,723	2,180	1.4
Insurance	23,302	28,295	4,993	21.4
Travel	34,000	30,250	(3,750)	(11.0)
Printing/Office Supplies	81,916	77,586	(4,330)	(5.3)
Postage	150,216	157,717	7,502	5.0
Telephone	73,899	80,123	6,224	8.4
Advertising & Public Relations	87,467	85,541	(1,926)	(2.2)
Corporate & Civic Dues	28,913	25,541	(3,372)	(11.7)
Vendor Fees	1,493,987	1,611,168	117,180	7.8
Other	<u>131,023</u>	<u>139,411</u>	<u>8,388</u>	6.4
Subtotal	<b>\$5,066,978</b>	<b>\$5,231,445</b>	<b>\$164,466</b>	<b>3.2</b>
Change In Claims Handling	(125,764)	29,873	155,637	(123.8)
Beacon MHSA	81,050	83,183	2,133	2.6
Pharmacy Benefit Management	38,798	40,529	1,731	4.5
Radiology Vendor Fee	0	0	0	-
HIPAA	29,165	29,676	510	1.8
Projects	<u>413,579</u>	<u>0</u>	<u>0</u>	-
<b>Total Expense</b>	<b><u>\$5,503,806</u></b>	<b><u>\$5,414,705</u></b>	<b><u>\$324,478</u></b>	<b>(1.6)</b>

**Budget Methodology**

The 2007 expenses were developed by multiplying 2006 projected actual by department with inflation factors.  
The 2007 Direct Pay budget was then adjusted for other known and anticipated changes that include:

- ♦ 2.4% decrease in enrollment for 2007 in comparison to 2006.
- ♦ Ratefiling costs will be similar to 2006.
- ♦ Eliminate impacts of 2006 non-recurring expenses.
- ♦ Pension expenses are reduced by 8.7% in 2007.

**Blue Cross & Blue Shield of Rhode Island**  
**Direct Pay - Comparison of CY08 Budget to CY07 Budget by Natural Account**

	<u>CY 2007 Budget</u>	<u>CY 2008 Budget</u>	<u>Increase (Decrease)</u>	<u>%</u>
Salaries And Wages	\$1,553,866	\$1,608,251	\$54,385	3.5
Temporary Empl Serv	11,951	12,370	418	3.5
Fringe Benefits	656,907	758,871	101,964	15.5
Outside Services	251,549	259,095	7,546	3.0
Legal	157,215	161,931	4,716	3.0
Rent	156,470	161,164	4,694	3.0
Equipment	54,133	55,757	1,624	3.0
Software	153,723	159,412	5,689	3.7
Insurance	28,295	29,143	849	3.0
Travel	30,250	31,157	907	3.0
Printing/Office Supplies	77,586	80,611	3,025	3.9
Postage	157,717	162,449	4,732	3.0
Telephone	80,123	82,527	2,404	3.0
Advertising & Public Relations	85,541	88,962	3,422	4.0
Corporate & Civic Dues	25,541	26,307	766	3.0
Vendor Fees	1,611,168	1,659,503	48,335	3.0
Other	<u>139,411</u>	<u>142,849</u>	<u>3,438</u>	2.5
<b>Subtotal</b>	<b>\$5,231,445</b>	<b>\$5,480,359</b>	<b>\$248,915</b>	4.8
Change In Claims Handling	29,873	21,917	(7,956)	(26.6)
Beacon MHSA	83,183	89,188	6,005	7.2
Pharmacy Benefit Management	40,529	42,290	1,761	4.3
Radiology Vendor Fee	0	52,722	52,722	-
HIPAA	29,676	30,148	472	1.6
Projects	<u>0</u>	<u>0</u>	<u>0</u>	-
<b>Total Expense</b>	<b><u>\$5,414,705</u></b>	<b><u>\$5,716,624</u></b>	<b><u>\$301,919</u></b>	5.6

**Budget Methodology**

The 2008 expenses were developed by multiplying 2007 budget by department with inflation factors. The 2008 Direct Pay budget was then adjusted for other known and anticipated changes that include:

- ♦ No change in enrollment for 2008 in comparison to 2007.
- ♦ Ratefiling costs will be similar to 2007

## **2007 Direct Pay Budget Narrative**

The following provides a breakdown of calendar year 2007 administrative expenses by natural expense account for Direct Pay products.

### **Salaries & Wages/Temporary Services**

Salaries, bonuses, overtime pay and outside temporary services are included in this natural expense account. The following departments are included in the 2007 Direct Pay budget with the allocation based on the nature of the work performed:

**Customer and Provider Services** (5.0 FTEs, salaries \$209,612) staff responds to questions from members and providers regarding benefit coverage, payment status, eligibility and various other issues.

**Individual Sales** (2.8 FTEs, salaries \$180,022) sells the Direct Pay product to the non-group market. Staff members are responsible for answering all inbound calls as they relate to the Direct Pay product. The process includes a thorough explanation of covered services, plan limitations, enrollment guidelines and benefits associated with the Direct Pay product.

**Marketing** (0.9 FTEs, salaries \$72,388) includes Product Marketing and support staff. The Product Marketing department is responsible for the development, implementation and ongoing management of the Direct Pay products and accounts for \$9,612 of the projected allocation. The following activities are performed within this unit:

- development and implementation of features and/or services that will make the product more competitive.
- development and maintenance of all Direct Pay sales and member materials.
- regular briefings of internal operating areas on Direct Pay benefits and administration.
- investigating and resolving any service and/or operational issues related to benefit design.

The remaining \$62,776 reflects the salaries for staff that support the Individual Sales and Product Marketing departments.

**SGU/Individual Underwriting** (3.1 FTEs, salaries \$161,688) reviews health questionnaires for applicants requesting the Preferred rate (Pool II) in one of the Direct Pay products.

The Medical Underwriters in the Small Group Underwriting Department review the health questionnaires and any recent Blue Cross/Blue Shield claims history to determine the health risk of an applicant. The department uses a health insurance medical manual as guidelines for making the risk assessment. If the underwriter does not have sufficient information to make the health risk assessment, the applicant may be required to submit additional medical information from their health care provider. The Medical Underwriter

## 2007 Direct Pay Budget Narrative

notifies the applicant regarding their eligibility for the Preferred rate through a letter. If the applicant is denied the Preferred rate they are informed of the medical condition(s) that did not meet the underwriting guidelines for acceptable risk. The Medical Underwriter also notifies the Membership Department of applications approved for the Preferred rate.

The Underwriting Unit is also responsible for administering the Direct Pay Premium Assistance Program which involves reviewing the premium assistance application and the applicant's prior year's income tax return. A letter of determination for the premium assistance program along with the letter concerning medical review is sent to the applicant. The application is coded according to the appropriate decision and forwarded to the Membership department.

**Non-Group Rating** (1.5 FTEs, salaries \$111,040) is responsible for activities associated with regulatory (rate) filing, forecasting, and development of claims reserves. Rate filing expenses account for \$63,437 of the total expense, while the remaining \$47,603 is related to claims reserve activities.

**Statistical** (0.4 FTEs, salaries \$32,865) is responsible for the pricing of product benefits, providing detailed enrollment analysis as well as trend analysis and other studies.

The remaining **Actuarial** departments (0.1 FTEs, salaries \$4,751) include Direct Pay's allocation of the cost related to forecasting, development of claims reserves, regulatory reporting and rate filings.

**Cash Receipts** (1.7 FTEs, salaries \$66,709) processes the individual premium payments made by subscribers. The process includes opening the mail, scanning the remittance, depositing the checks and posting the payments to the subscriber's account.

The remaining departments in **Finance** (1.2 FTEs, salaries of \$92,886) are responsible for rate filing activities and day to day financial activities necessary to run the business. The rate filing activities include the development of operating expense budgets and responding to Attorney General data requests. Direct Pay is also allocated a share of day to day financial activities such as: Accounts Payable, Payroll, Corporate Accounting, etc.

**Information Technology/Governance** (1.5 FTE's, salaries \$133,446) encompasses the following functions:

- Project management oversees the assignments relating to Direct Pay, and limits cost overruns for projects directly relating to Direct Pay (e.g. Direct Pay Affordability Study) and those indirectly benefiting Direct Pay (e.g. Enterprise Wide Business Continuity, Individual Provider Identifier).
- Governance of the Perot outsourcing agreement relating to membership and claims processing functions for Direct Pay, ensuring that members are enrolled accurately and timely and that claims are processed according to standards.

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- Web site development and maintenance enhances the BCBSRI web site allowing Direct Pay members access to obtain information relating to specific health and wellness topics.

**Communications Services** (1.0 FTEs, salaries \$74,499) prepares Direct Pay benefit summaries, provider directories and various other corporate communications initiatives (e.g. Choices Magazine, Depression Manuals, etc.).

**Quality Assurance & External Audits** (0.4 FTEs, salaries \$17,658) performs claims audits, reports on numerous performance measures required by the Blue Cross Blue Shield Association, and coordinates activities for external audits. These audits ensure that Direct Pay members are enrolled on a timely basis and their claims are paid properly and timely.

The **Legal** department (0.3 FTEs, salaries \$35,420) provides guidance on contracts, reviews subscriber agreements and works with outside counsel on Direct Pay rate filings and general litigation.

**Human Resources** (0.5 FTEs, salaries \$38,009) performs all employee recruitment and is responsible for administering compensation, benefits, and training for all employees. The work in this department impacts all employees who work on Direct Pay activities.

Staff time devoted to the transition to a **replacement claims system** (from LRSP) to claims system development will allocate \$29,485 (0.4 FTEs) to Direct Pay. This important system upgrade will benefit all products by providing a state of the art claims processing system.

**Grievance & Appeals** (0.6 FTEs, salaries \$32,327) responds to appeals from Direct Pay members.

**Office Services** (0.5 FTEs, salaries \$27,251) is responsible for management of facilities, the internal print shop and mail delivery, benefiting those employees who work on Direct Pay.

**Internal Audit** (0.2 FTEs, salaries \$15,726) is responsible for the review of BCBSRI internal controls, payment processes and systems audits.

**Corporate Compliance** (0.1 FTEs, salaries \$9,815) develops and enforces the corporate compliance program.

**Billing Validation** (0.4 FTEs, salaries \$26,366) is responsible for auditing how providers bill BCBSRI relative to American Medical Association (AMA) and plan contractual requirements. The AMA provides current procedural terminology (CPT) codes.

**Contracting** (1.0 FTEs, salaries \$74,278) is responsible for the negotiation of contracts for all hospitals, physicians, ancillary providers, pharmacies, and vendors. In addition,

## 2007 Direct Pay Budget Narrative

this department is responsible for the maintenance of these contracts which includes administration, contract analysis, pricing updates, credentialing providers and maintaining provider databases.

Expenses for **Corporate Executives, Legislative Affairs, Community Relations, General Corporate Expenses, Program Management, and Medical Management** are corporate in nature and are allocated to all product lines and market segments resulting in a charge to Direct Pay of \$119,344 (1.4 FTEs).

The succeeding chart provides a comparison for the Full Time Equivalents allocated to Direct Pay with the total staff in each department.

	<b>Full Time Equivalents</b>	
	<b>Direct Pay</b>	<b>Total</b>
Customer & Provider Services	5.0	206.0
Individual Sales	2.8	16.0
Marketing	0.9	88.5
SGU/Individual Underwriting	3.1	22.0
Non-Group Rating	1.5	9.5
Statistical	0.4	19.5
Actuarial	0.1	34.5
Cash Receipts	1.7	14.5
Finance	1.2	57.5
Information Technology/Governance	1.5	66.0
Communications Services	1.0	28.0
Quality Assurance & External Audits	0.4	21.0
Legal	0.3	12.5
Human Resources	0.5	20.0
Claims system replacement	0.4	17.5
Grievance & Appeals	0.6	26.0
Office Services	0.5	21.0
Internal Audit	0.2	10.0
Corporate Compliance	0.1	6.0
Billing Validation	0.4	20.0
Contracting	1.0	57.5
All Other	1.4	307.0
<b>TOTAL</b>	<b>25.0</b>	<b>1,080.5</b>

### **Fringe Benefits**

Fringe benefits are generally charged to cost centers based on the costs incurred at the employee level. These costs are then allocated to product lines in the same manner as the employees' salaries and wages. The specific components of fringe benefits are outlined below.

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### Payroll Taxes

FICA, Federal & State Unemployment, Medicare taxes paid on salaries and wages referenced above. For the purposes of this computation, we assumed that the tax rates will remain constant and maximums will move in relation to the salary increases.

### Health Insurance

The Health Insurance expense includes:

- Comprehensive group health coverage for individual and families
- Group Dental coverage with an annual \$1,200 maximum
- Basic Life Insurance & Accidental Death & Dismemberment
- Post Retirement Medical Benefits for employees that were hired prior to January 1, 1992 and retire after age 55 after attaining minimum service requirements.

### Pension

Expenses within this category include:

- Regular Pension - The Retirement Plan is a Defined Benefit Plan which provides a monthly retirement benefit to eligible participants at normal retirement, age 65 (full benefit) or at early retirement, age 55 to 64 (actuarially reduced benefit.) Vesting occurs in the Retirement Plan upon the completion of five plan years of service. Expenses are calculated in accordance with Financial Accounting Standard (FAS) #87.
- Supplemental Executive Retirement Plan (SERP) provides benefits to employees (vice presidents and above) who have been designated as eligible by the Board of Directors vote. Vesting requirements of at least 5 years at age 55 or 15 years of services at any age prior to 55 are necessary prior to payment of any benefits. Expenses are determined in accordance with FAS #87.

### Fringe -Other

This category of expense includes:

- Money Match Employee Savings Plan. The expenses associated with this 401k program reflect the employer match costs (50% on employee pre tax contributions up to 6%) and the costs associated with Massachusetts Mutual's administration of the program.
- Employee Long Term Disability Insurance provides the employee with partial disability insurance in the event of total disability.
- Workers Compensation Insurance.

## 2007 Direct Pay Budget Narrative

### Outside Services

Outside Services are external personnel (excluding lawyers) engaged to provide expertise or services that are not available from the existing staff, or to handle project work. The projected 2007 allocation to Direct Pay is \$251,549. Major expense inclusions are noted below:

- **Information Technology** – Outside professional services are utilized to assist on various projects and technical assistance on website development and maintenance. The projected 2007 impact on Direct Pay is \$38,717. The primary methods of allocation for Information Technology are machine utilization, paid claims, contract months, and interplan teleprocessing services.
- **Compliance and Audit** functions add \$37,119 to the Outside Services line item. Compliance activities include conforming to Sarbanes-Oxley principles and the BCBSRI compliance program. Audit activities include technical support for internal audits and the annual corporate audit. These activities are corporate in nature and are allocated to all lines of business.
- **Product Marketing** – Outside services are utilized to conduct market research and customer satisfaction surveys (including Direct Pay members) resulting in a projected allocation of \$32,409. These expenses are allocated consistent with the overall work performed within the department.
- **Communications Services** – The cost reflects the services provided by Rivers Doyle & Walsh (\$30,230) for Public Relations and Advertising.
- **Initiatives Management Office** – BCBSRI establishes a budget each year for work on mandated or high priority corporate projects many of which will benefit all product lines. The projected allocation for Direct Pay is \$30,000.
- **Corporate Expense** – This cost reflects the projected allocation attributable to Direct Pay for Business Continuity expenses (\$24,232).
- **Contracting** – Outside professional services are allocated based on paid claims, and the allocation to Direct Pay is \$13,106.
- **Human Resources** – Outside professional services are used for a variety of activities including compensation benchmarking, pension valuation, employee training and support of Human Resource systems. The allocation is estimated to be \$10,956. The primary method of allocation for Human Resources is Full-Time Equivalents (FTEs).
- **Finance** – Outside services are utilized to assist with BCBSA directed initiatives, such as SAS 70, and Model Rule Audit Compliance. The projected allocation for Direct Pay is \$10,464.
- The remaining \$24,316 is spread across numerous operating departments and is used to support the operations in these areas.



## **2007 Direct Pay Budget Narrative**

### **Legal**

Projected costs for outside legal services are \$157,215 including \$151,419 for costs associated with the rate filing and related work. The budget also includes \$5,796 for Direct Pay's share of corporate litigation and other legal services. The rate filing expenses are charged directly to Direct Pay and the remainder of the expenses are corporate in nature, and is charged based on total cost ratio.

### **Facilities & Occupancy**

This expense category includes all costs related to the operation of the facilities occupied by BCBSRI employees. The \$156,470 allocation reflects less than 3% of the anticipated facilities costs for the corporation and is related to the departments whose activities allocate to Direct Pay as mentioned in the Salaries and Wages portion of this exhibit as well as the computer operations area.

### **Equipment**

The allocation of equipment expenses are expected to be \$54,133 for Direct Pay in 2007.

Depreciation, property taxes, rental and maintenance associated with employee workstations accounts for \$38,323 of the budget. The budget also includes \$15,810 for the purchase of equipment costing less than \$1,500 per item, by the departments listed in the salaries and wages section.

### **Software**

Software charges are anticipated to be \$153,723 for Direct Pay. The majority of this expense is associated with depreciation, property taxes, and maintenance agreements for Information Technology (IT) systems (\$66,871), the Customer Relationship Management system (\$17,992) and the Fraud and Abuse software (\$10,134).

The IT systems include E-business (BCBSRI.com), HIPAA and license agreements used by the Data Center. The BCBSRI website is accessible by Direct Pay subscribers to review benefits, claims activity and wellness tips.

The Customer Relationship Management system is used by Customer Service staff to assist subscribers with questions from members and providers regarding benefit coverage, payment status and various other issues.

The Fraud and Abuse software is utilized by the Special Investigations Unit to detect claim trends that may be considered fraudulent. This project has been mandated by the Center for Medicare and Medicaid Services (CMS) requiring all Part D sponsors to institute comprehensive plans to detect, correct and prevent fraud, waste and abuse.

## **2007 Direct Pay Budget Narrative**

The remaining \$58,726 is for software packages, depreciation and property taxes associated with departments whose activities impact Direct Pay (e.g. Financial Systems, compliance software, etc.).

### **Insurance**

The Insurance account includes the following coverages as a prudent risk strategy:

- Directors & Officers
- e- Business Liability
- Employment Practices Liability
- Errors & Omission
- Managed Care Liability

The Direct Pay allocation of these corporate expenses is anticipated to be \$28,295.

### **Travel**

Travel expenses (\$30,250) are allocated to product lines based on the reasons and benefits derived from the travel. Employee travel that is beneficial to the overall performance of the employee is allocated to product lines based on the allocation of salaries and wages for the employees department. Most travel falls into this category and includes educational conferences, training seminars on new systems and/or processes, and Blue Cross Blue Shield Association events.

If the travel benefits a specific product line or market segment other than Direct Pay then the travel will be charged to that product/segment directly and there will be no charge to Direct Pay.

### **Printing, Stationery and Office Supplies**

The \$69,742 printing budget for Direct Pay includes materials such as welcome letters, applications and benefit summaries.

The allocation of Office Supplies to Direct Pay (\$7,843) is directly related to the activities of the departments mentioned in the salaries and wages narrative. This category of expense includes toner cartridges for laser printers, paper, pens, folders, etc.

## **2007 Direct Pay Budget Narrative**

### **Postage**

The \$157,717 expense reflects the allocation of postage paid to mail the following items to Direct Pay subscribers:

- enrollment kits,
- provider directories,
- premium billings, and
- claims correspondence.

### **Telephone**

Telephone expenses are expected to be \$80,123 in 2007 and include the following:

- line charges for Customer/Provider Service,
- data lines and web hosting fees for BCBSRI.com, and
- line charges necessary for all other employees to conduct business.

### **Advertising and Public Relations**

Advertising is used to build brand awareness and understanding, sell products and services and provide important information to the community. BCBSRI uses a number of diverse media to communicate consistent messages regarding our competitive differentials, superior services and product offerings, and our brand position.

Direct Pay is charged directly for messages that pertain only to this product and is allocated a pro rata share of the costs of general advertising resulting in a total expense of \$85,541. No cost is allocated to Direct Pay for advertisements that relate specifically to any other products (e.g. Healthmate, Blue Cross Dental).

### **Corporate & Civic Dues**

Corporate and Civic Dues add \$25,541 to the 2007 expense budget and are divided between two sub-categories: Dues and Contributions.

Direct Pay will be charged \$25,420 for Dues expense in 2007 with \$22,136 of this amount for corporate dues assessed by the Blue Cross Blue Shield Association. The Association calculates the dues each plan must pay based on the number of contracts and revenue that plan has. Direct Pay is allocated its share of these expenses based on a percentage of revenue. The remaining \$3,284 is for corporate or professional dues which are allocated based on the departmental activities as mentioned in the salaries and wages section of this exhibit.

## **2007 Direct Pay Budget Narrative**

Charitable contributions represent the remaining \$121 with the majority of this allocation for contributions to the United Way. BCBSRI provides contributions to various causes that are in alignment with our mission and these organizations are dedicated to improving the health and quality of life of all Rhode Island residents.

### **Vendor Fees**

Blue Cross has outsourced the following functions to Perot Systems Corporation (Perot) with a cost of \$1,611,168 to Direct Pay:

- \$589,988 - Data Center Operations.
- \$347,650 - Claims Processing including Claims Disbursements.
- \$331,047 - Application Development and Maintenance.
- \$159,623 - Membership Services.
- \$150,937 - Network & Telecommunication Services.
- \$ 31,922 - Desk Side Services.

**Data Center Operations (\$589,988)** – Provides services necessary for the operation, administration, management and support of all, mainframe, printing and mailing applications. This process includes, but is not limited to:

- performing master console functions, including automation, centralization and consolidation of console functions and use of automation tools,
- managing, maintaining, monitoring, and controlling scheduled and unscheduled on-line batch processing,
- completing BCBSRI-defined processing and backups in correct sequence and within the time periods designated by BCBSRI,
- performing load balancing and where applicable perform as much scheduled batch work with automated tools,
- monitoring, verifying, and making appropriate adjustments to support proper executions of applications,
- identifying job and schedule dependencies, creating and maintaining job information dependencies on the master scheduling database, and prioritizing/scheduling batch jobs,
- supporting, maintaining and coordinating all on-line print/imaging/insertion activities,
- preparing reports for distribution and distributing them,
- developing, maintaining, ordering and storing print/image/insertion output forms libraries, inventories, and supplies,
- coordinating with external print/image/insertion third party vendors, and coordinating ad hoc mailing requests in the same manner as mail insertion services.
- assuring that midrange servers are kept in working order, and that procedures are developed with reasonably adequate controls and audit trails.

## **2007 Direct Pay Budget Narrative**

- scheduling, coordinating, and overseeing all activities requiring the physical presence of third party vendors.
- coordinating rollouts and upgrades of equipment and applications, including responsibility for coordinating any testing, scheduling and installation of such equipment or application.
- managing Direct Access Storage Devices (DASD) by monitoring and controlling storage performance, assigning and initializing DASD volumes, determining data set and volume placement, and setting and maintaining DASD resource efficiency/standards.
- providing performance monitoring, system performance tuning, and making recommendations based on system performance review.
- monitoring system utilization and capacity and advising BCBSRI of the need for additional capacity.
- providing daily monitoring and support for all servers, including, but not limited to: loading operating system software, installing back-up software and maintaining backups, performing restoration of data upon request, providing systems level support to the Application Development and Maintenance (ADM) team, providing data storage management, implementing and adhering to change control procedures, and administering clustered servers on different hardware platforms.

The primary method of allocation for Data Center Operations is machine utilization.

**Claims Processing (\$347,650)** – Perot is responsible for all aspects of Direct Pay Claims Administration including Claims Receipt and Imaging, Claims Entry, Suspense Relief, and Correspondence and Adjustment processing. The primary method of allocation is based on paid claims.

**Applications Development & Maintenance (\$331,047)** – Provide programming support for all systems applications used by Blue Cross & Blue Shield of Rhode Island. Direct Pay is charged directly for programming efforts that are specifically related to Direct Pay and the program is charged a pro rata share for generic applications (e.g. LRSP maintenance, Financial Systems, etc.).

**Membership Services (\$159,623)** – Perot is responsible for all Direct Pay Membership functions and is required to:

- add new Direct Pay members to our membership files and update any membership changes to existing members,
- issue ID cards and Welcome Kits to subscribers,
- develop and mail premium bills.

The primary method of allocation for Membership Services is member months.

## **2007 Direct Pay Budget Narrative**

### **Network & Telecommunication Services (\$150,937)**

- Manage the Wide Area Network (WAN) and Local Area Network (LAN) at BCBSRI sites.
- Perform the design, installation, termination, maintenance, and documentation of all intra-building copper and fiber optic cabling for Ethernet, FDDI, SONET, ATM and WAN environments.
- Install and maintain WAN connections and upgrades.
- Monitor WAN and leveraged LAN bandwidth, report on Internet access and usage, and maintain adequate Internet access bandwidth in accordance with business needs.
- Support all BCBSRI internal and external audits for regulatory or business function purposes.
- Perform all functions required in order to support telecommunication services of the BCBSRI user community (order, install, remove, upgrade, replace, manage, and maintain equipment and software).

The primary method of allocation for Network & Telecommunication Services is Full-Time Equivalents (FTEs).

### **Desk Side Services (\$31,922)**

- Perform maintenance on desk side equipment and software as necessary.
- Order, build and deploy desk side equipment as requested by BCBSRI users.
- Provide break-fix field service to all BCBSRI equipment.
- Improve the efficiency and reliability of desk side equipment. This process shall include correction of all desk side equipment problems that require software and/or desk side maintenance, switching devices, and encryption/security devices.
- Recommend solutions and implement mutually agreed upon processes and procedures to optimize the overall infrastructure.
- Provide Help Desk services including: providing a single point of contact for reported problems, questions or requests. Provide first call problem resolution and route problems to the proper technical area.

The primary method of allocation for Desk Side Services is Full-Time Equivalents (FTEs).

## **2007 Direct Pay Budget Narrative**

### **Other**

Payments for out of area fees relating to Direct Pay claims account for \$80,158 of the budget. These fees are paid to other Blue Cross and Blue Shield plans when BCBSRI members obtain covered services outside the State of Rhode Island. The fees enable BCBSRI to utilize the discounts negotiated by other plans.

Employee education and other miscellaneous items account for the remaining \$59,253. These expenses are allocated to Direct Pay based on the department activities as noted in the salaries and wages narrative.

### **HIPAA**

The Direct Pay share of the cost of complying with federally regulated guidelines for the privacy, security, and transaction code sets is estimated at \$29,676. The primary method of allocation for HIPAA is total cost ratio.

### **Change in Claims Handling**

The estimated liability to process outstanding Direct Pay claims is expected to increase by \$29,873 in 2007. The expectation is the increasing claims trend will result in more claims outstanding at year-end.

### **Pharmacy Benefit Management Fee**

Administrative cost (\$40,529) pertaining to the outsourcing of drug claims processing by Wellpoint and is based on paid claims.

### **Mental Health/Substance Abuse Management Fee**

\$.47 pmpm charge relating to the outsourcing preauthorization prior to seeking assistance from a mental health professional.